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FINDING A KEY TO THE MARKET

New features are just not enough to stay alive in a flat market

U.S. CHANGES POSITION ON HIGH-TECH EXPORTS

Administration wants to relax rules on sales to Eastern Europe

TTSI UNVEILS INTELLIGENT NETWORK PRODUCTS

Tandem offers multifunction SCP, service management system

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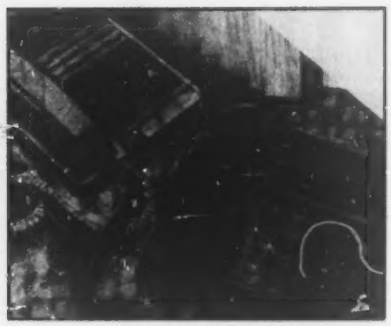

The key system market is flat—even Columbus would admit it. But there's still money to be made and plenty of opportunity. Cover art by Laura Doyle

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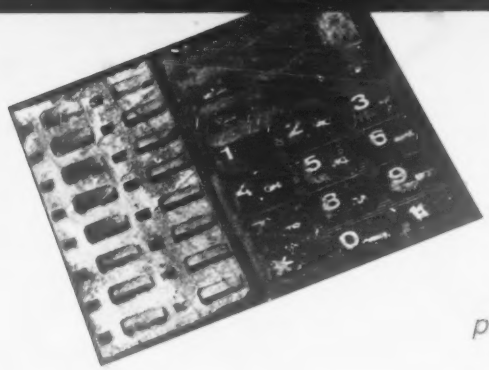

Finding a key to the market

Even Columbus would admit it—
the key system market is flat, flat, flat.
But there's still money to be had and
plenty of opportunities just around the corner

DEBORAH PFEIFFER, Associate Editor

The key system market is flat, and that's a fact. Anyone in the industry—manufacturer, distributor, analyst—will tell you the same story.

But despite having a flat growth rate, the industry isn't disappearing. In 1989, it boasted $4.3 million in shipped stations and was valued at $990 million, according to the North American Telecommunications Association's 1990 *Telecommunications Market Review and Forecast.* The market also is competitive—the top 10 players in terms of market share have shifted quite a bit in the last couple of years (Tables 1 and 2). This could translate into future opportunities for manufacturers if they take advantage of current trends.

The key system market is flat because it's a com-

continued on page 24

TABLE 1
1989 KEY SYSTEM MARKET SHARES
(BASED ON STATIONS SHIPPED)

AT&T	21.7%
TIE	19.0
Executone	9.7
Toshiba	7.6
Northern Telecom	4.8
Inter-Tel	4.5
Iwatsu	3.7
Panasonic	3.7
NEC	3.5
Fujitsu	3.2

Source: Northern Business Information/Datapro

TABLE 2
1988 KEY SYSTEM MARKET SHARES
(BASED ON STATIONS SHIPPED)

AT&T	20.8%
TIE	17.2
Executone	15.0
Toshiba	8.3
NEC	4.7
Iwatsu	3.5
Inter-Tel	3.5
Fujitsu	3.0
Nitsi	2.5
Comdial	2.3

Source: Northern Business Information/Datapro

Finding a Key *continued*

modity market. Although there are several industry players, most companies' systems share similar features and are differentiated primarily by price. Many industry participants had counted on a demand for digital and integrated services digital network key systems to refuel the market. Although digital and ISDN systems still may fuel growth, replacement cycles or change-outs haven't happened as fast as some manufacturers had counted on. In many cases, the customer prefers to maintain its installed base and enhance it with adjuncts such as voice mail and auto-attendant, which have become increasingly available and are less expensive than buying brand new systems.

Since features are fairly common among all systems and price margins are being squeezed, many companies are struggling to find other methods to differentiate their products.

Since features are fairly common among all systems and price margins are being squeezed, many companies are struggling to find other methods to differentiate their products.

Service with a Smile

"Service and distribution are big things in a mature market, because everyone's selling the same boxes. And some are just selling each other boxes," says Richard Klugman, research analyst for Northern Business Information/Datapro. Besides service and distribution, companies also have targeted specific sections of the market such as marketing products with lower line sizes to small businesses.

For example, AT&T manufactures two lines—Spirit and Merlin—with the Spirit line geared toward companies that do not want all the features that Merlin offers, says Peter Bernstein, senior analyst for Probe Research. Many companies are stressing ease of system use, the ability to integrate and update systems, voice-data capabilities and special vertical market applications.

"This is a competitive market, and it is forcing margins down at the manufacturing level and at the dealer level. In this market, you've got to bring something else to the table other than technology and price," says Peter J. Harrow, vice president of national sales for WIN Communications Corp. "We've focused on the service issue. After all, how many features can you put on a telephone system that users could regularly use?" His company announced its 96-port Marathon 100D digital key system with a built-in 2B+D protocol at NATA's Unicom '89 show in Dallas last December. WIN's new service plan, based in part on an extensive survey of customers about its potential marketing ideas, was one of many announced at the show.

AT&T offers a shining example of how companies can make money by targeting certain areas of the market. The company has been the market leader for several years now. It is unique due to its dedicated sales and service support for small businesses, says Miles Penland, manager-strategic analysis for AT&T General Business Systems Division. "This puts us in a position to get feedback from the customers," he says. The company is able to develop new products and services based on the suggestions brought back through the direct sales channel.

AT&T's new Merlin cordless business phone, which works with the company's existing Merlin line, exemplifies the use of innovation to fulfill the needs of small business customers, according to Penland.

Probe Research's Bernstein agrees. "The Merlin cordless phone brings wireless into the office. It's a new product idea that vendors can sell—it's new and exciting. The cordless phone will save people money and give them mobility in the office."

For example, the system is attractive to wholesale distributors with large warehouses and auto dealerships, notes Penland.

But the cordless phone will be an interim product

only, Bernstein predicts, leading to a digital wireless key system similar to those being introduced in Europe early next year.

Changing Channels

Key system manufacturers also have experimented with changes in distribution to cut costs and thereby distinguish their products in the market.

"Distribution is always critical in a commodity market. You want to get the best level of representation," says Ken Landoline, associate director, telecommunications industry service for Dataquest. Several manufacturers have switched to direct distribution in the past few years in an attempt to copy AT&T's success.

Most have been unsuccessful, says Klugman. "There's a problem with gobbling up interconnects—it doesn't help if the customers aren't familiar with the product."

Northern Telecom, however, has used distribution to spur sales of its Meridian Norstar line of digital key telephone systems. In 1989, the company went from being essentially a non-player in the market to landing in the top 5 list. Northern has expanded its market share predominantly by enlisting all seven Bell regional holding companies' operating companies to distribute Norstar, as well as the major national Independents and some regional distributors, says John Losier, general manager of Meridian Key Division. "We are supporting distribution in every area of cost associated with the business," he notes. For example, through its Norstar Express 24-hour delivery service, Northern essentially manages all the inventory, providing a shield for distributors and cutting their carrying costs, he says. The company also has concentrated on making the product simple to install.

But despite these successes due to innovative service and distribution methods, most key systems still are sold solely on price.

Northern Telecom's Meridian Norstar M7324 digital key telephone

'Service and distribution are big things in a mature market, because everyone's selling the same boxes.'

"The players in the market have tried almost everything to differentiate—modularity, size, features, maintenance contracts, delivery times, giveaway programs. There is little that hasn't been tried in the sales approach. But price still seems to be the differentiating factor," Losier says.

The drive to lower prices to remain competitive has brought on several industry changes. While some companies have tried different distribution methods to gain cost efficiencies, others have turned to manufacturing outside of the United States to cut prices. This price-cutting solution has caused quite a tremor in the business.

AT&T Merlin cordless telephone

Don't Dump on Me

In December 1988, AT&T and Comdial filed an anti-dumping petition with the U.S. International Trade Commission and the U.S. Department of Commerce against small telephone system manufacturers importing systems (mainly key systems) produced in Japan, South Korea and Taiwan and selling them in the U.S. for less than fair value. The Commerce Department later assessed most of the companies cited, with the exception of Sun Moon Star, with dumping margins. Those companies now are required to post cash, bonds or securities in the amount of the dumping rate on all subsequent shipments. Among the specific companies named were Toshiba and Matsushita of Japan, Nitsuko of Taiwan, and

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Finding a Key *continued*

Samsung Group and Lucky Gold Star Group of Korea.

There is some debate on how this anti-dumping decision will affect the industry. Iwatsu America, one of the companies potentially affected by the decision, actually started planning to manufacture in the U.S. more than two years ago because of trade issues and is currently doing so out of its Carlstadt, N.J., headquarters. The company thinks this will make it more attractive to customers, says Nobuo Sato, vice president of marketing for Iwatsu. Toshiba has announced plans to expand its manufacturing outside of its facility in Irvine, Calif. Several interconnects have scrambled to align themselves with other, or more, companies, anticipating that affected manufacturers will be forced to raise their prices.

"The whole dumping question has had a big effect on the industry. We can assume that in 1990 the margin pressures will not be as great. But prices won't drop. The market still will be incredibly competitive because there are a lot of players," notes Bernstein. "You're probably going to see off-shore vendors starting to manufacture in the U.S. It will be an interesting shift, seeing how that works with distribution."

AT&T, an initiator of the petition, sees the decision by the Commerce Department and ITC as setting up a level playing field within the industry, says spokeswoman Simone Acque. She foresees some companies moving their manufacturing operations to this country.

"For all companies in business it's very risky to raise prices, so they're trying to move on-shore. I think it will be good for AT&T; it will buy them market share. It will also cause some people to drop out. Otherwise the anti-dumping decision will have a negligible effect on companies, other than the cost of moving product facilities," says Landoline.

Prices probably won't go up in the long term despite the anti-dumping decision, agrees Klugman. "Some foreign companies can only sell in this country. It's the biggest key system market in the world, and companies can't afford to be shut out of it." He notes, though, that many companies already have relocated or will relocate their assembling operations to Malaysia or Thailand because of the cheap labor there, since these countries weren't cited in the decision. "So they're clear for now. I don't know what will happen in the future. But I doubt we'll see increased manufacturing in the U.S. because of this," he adds.

Northern Telecom, which manufactures in North America, also was not directly hit by the anti-dumping ruling, but industry prices "will reflect the true cost of building a product, so any effect would have to be good for us," says Losier.

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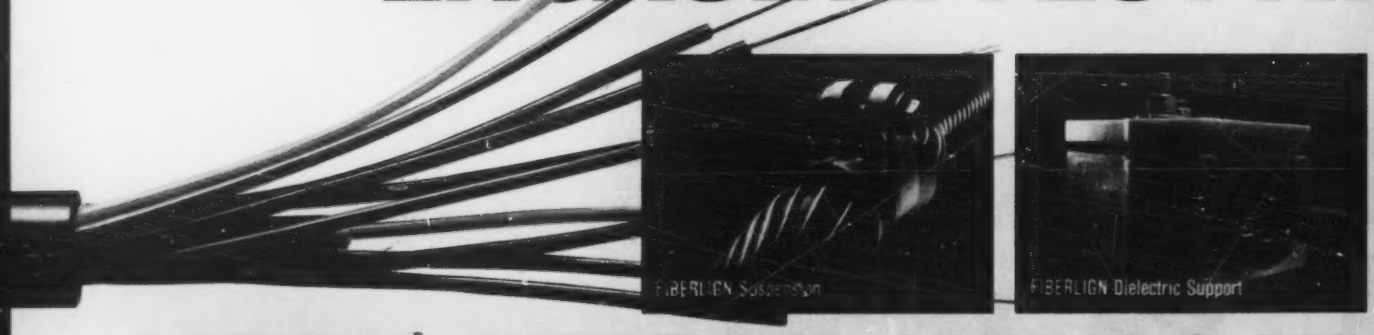

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Change-outs in digital and ISDN have yet to occur. Analysts agree that digital hasn't yet had the impact on the market that was hoped for. Increasingly, companies are introducing digital systems, including recent introductions such as Telrad Telecommunications Inc.'s Symphony II and Sun Moon Star's DKTS-Mini. The timing for ISDN also is not right. Several companies have built-in voice-data capabilities comparable to ISDN services. But many companies, especially smaller ones, are waiting until 2B+D standards are set and for ISDN services to be offered over the public network.

"Norstar offers ISDN in the way it handles messaging and simultaneous voice and data, and its internal signaling is based on basic rate. When ISDN is offered on the public network, Norstar's design will allow easy migration," says Losier. Northern will implement ISDN on Norstar depending on how ISDN is deployed in the public network, he says.

It will be about five years before a major surge in ISDN key systems occurs, says Klugman.

ISDN behind Centrex will be a major opportunity for key system makers, according to Bernstein. Since the nature of Centrex has been changing, making it more popular with small businesses, systems with basic rate for small businesses will give the market a good boost, he says.

Other market trends to watch for are the proliferation of voice mail and automatic call distribution capabilities, notes Bernstein. The increasing number of hybrids, switches that can be configured as key systems, PBXs or something in between, also has had its effect on the market. Products such as Panasonic's 192-port DBS, Fujitsu Business Communication Systems' Starlog II and Northwestern Bell Phones' Integra hybrid systems are examples of this effort to carve a niche in the market. And there is some debate as to whether the lower costs for PBXs are taking business from the high end of the key system market. It's difficult to determine how key systems are competing with PBXs because of the proliferation of hybrid systems, notes Bernstein. "It's hard to say what the animal is in the first place. [The terms key system and PBX] are really artificial classifications—it becomes a semantic argument."

But Dataquest predicts a clear trend. The company estimates that the compound average growth rate for the number of U.S. phone lines shipped from 1989 to 1993 in the one- to eight-line market will be 4.7%. The same figure for the 48+ line market, however, will be −6.1%. Dataquest attributes this negative figure to lower PBX prices.

Key system manufacturers do have choices. Figuring out what new feature to add to a new product isn't one of them. But acting on the strengths of the company and the market is. ■

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